The Honorable Thomas S. Zilly

UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF WASHINGTON
AT SEATTLE

STRAITSHOT RC, LLC, a Delaware corporation,

Plaintiffs,

v.

TELEKENEX, INC., a Delaware corporation; MARK PRUDELL and JOY PRUDELL, husband and wife and the marital community composed thereof; MARK RADFORD and NIKKI RADFORD, husband and wife and the marital community composed thereof; JOSHUA SUMMERS and JULIA SUMMERS, husband and wife and the marital community composed thereof; ANTHONY ZABIT and JANE DOE ZABIT, husband and wife and the marital community composed thereof; BRANDON CHANEY and JANE DOE CHANEY, husband and wife and the marital community composed thereof; MAMMOTH NETWORKS, LLC; BRIAN WORTHEN and JANE DOE WORTHEN, husband and wife and the marital community composed thereof; and IXC HOLDINGS, INC., a Delaware corporation,

Defendants.

Case No. 2:10-cv-00268-TSZ

DEFENDANTS' RESPONSE TO PLAINTIFF'S MOTION FOR TEMPORARY RESTRAINING ORDER

FILED UNDER SEAL

NOTE ON MOTION CALENDAR: JUNE 10, 2011

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TELEKENEX, INC., a Delaware Corporation,

Third-Party Plaintiff,

v.

STRAITSHOT RC, LLC., a Delaware limited liability company; STEPHEN PERRY and JANE DOE PERRY, and the marital community composed thereof; and ANDREW GOLD and JANE DOE GOLD, and the marital community composed thereof,

Third-Party Defendants.

MAMMOTH NETWORKS, LLC, a Wyoming limited liability company,

Third-Party Plaintiff,

v.

CLARITAGE STRATEGY FUND, L.P., a Cayman Islands limited partnership; and STRAITSHOT RC, LLC, a Delaware limited liability company,

Third-Party Defendants.

I. INTRODUCTION

Plaintiff's Motion for Temporary Restraining Order is directly contrary to precedent established by the United States Supreme Court and the Ninth Circuit Court of Appeals. *See*, *Grupo Mexicano de Desarrollo v. Alliance Bond Fund, Inc.*, 527 U.S. 308, 119 S.Ct. 1961, 144 L.Ed.2d 319 (1999); *Dateline Exports, Inc. v. Basic Construction, Inc*, 306 F.3d 912 (9th Cir. 2002). Both of these decisions establish "a district court does not have the authority to issue a preliminary injunction [or a TRO, as the standard is the same] preventing a party from disposing of assets pending adjudication of a claim for money damages." *Dateline*, 306 F.3d at 912, citing *Grupo Mexicano*, 527 U.S. at 333.

Even if the law applicable to Plaintiff's Motion were not so clear, Plaintiff does not meet the standard for injunctive relief. In its labored effort to meet this difficult standard, Plaintiff

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materially misrepresents the purchase agreement pending between IXC Holdings (the purchaser last August of the assets of Telekenex, and, for purposes of this motion, Telekenex' successor) and TelePacific Managed Services ("TelePacific"). IXC Holdings ("IXCH") is not conducting a fire sale or giving away the assets of Telekenex—the transaction between IXCH and TelePacific is an arms length transaction between two sophisticated, capable companies with a history of success in the telecommunications industry. [redacted]

The Telekenex Defendants ask that the Court deny this motion, preclude any future efforts at obtaining a preliminary injunction, and award reasonable costs to the Telekenex Defendants attributable to this baseless request.

II. RELEVANT FACTS

A. The Telekenex/TelePacific Transaction.

In mid-2010, Telekenex sought financing to restructure its debt. Telekenex approached Wellington Financial, LP ("Wellington") to obtain the financing, and, on August 5, 2010, a loan and security agreement was executed between the two. Declaration of Chaney, ¶3. Preliminary to this agreement, Wellington requested, and Telekenex agreed, that "IXC Holdings Inc. shall have completed the acquisition of Telekenex, Inc. on terms reasonably satisfactory to Lender....". Decl. of Chaney, ¶3. The acquisition of the assets of Telekenex by IXCH was not an arms

[1] Plaintiff's counsel's guess work about how the proceeds of this transaction are to be distributed is not supported by any provision in the deal documents. There is a point—and it should occur soon—when Plaintiff must cease making inflammatory accusations and start making statements that are supported by facts.

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length transaction, but the price paid by IXCH was based upon a valuation by a third-party appraiser. Decl. of Chaney, ¶3. Straitshot does not--in fact cannot--argue that the appraiser's valuation was insufficient at the time of this transaction.

On April 28, 2011, following months of arms-length negotiations, [redacted]

III. ARGUMENT

A. A District Court Lacks Authority to Issue a Preliminary Injunction Pending Adjudication of a Claim for Money Damages

In *Grupo Mexicano*, 527 U.S. 319, the Supreme Court overturned a District Court's preliminary injunction issued to prevent a party to the litigation, Grupo Mexicano, from disposing of its only assets before judgment. The Supreme Court discussed, at length, the

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[2] IXC—not Telekenex--is the company that acquired Straitshot's former competitor, AuBeta Networks. At the time of the events leading to this lawsuit, IXC had not acquired AuBeta, and, in fact, did not exist. IXC's assets are not at issue in this lawsuit.

[3] To the extent that Plaintiff's concern is that IXC, Inc, the non-party to this lawsuit, will receive the lion's share of the TelePacific sales price, the agreement clearly provides otherwise. Of the $32,000,000 purchase price, $26M is allocated to IXC Holdings and $6M to IXC Inc. Of the $6M allocated to IXC Inc., $5.5M is dedicated to payment of a third-party, nonaffiliated secured creditor. *See*, Decl. of Chaney.

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historical equity powers of the federal courts, then ruled "we hold that the District Court had no authority to issue a preliminary injunction preventing petitioners from disposing of their assets pending adjudication of respondents' contract claim for money damages." *Grupo Mexicano*, 527 U.S. at 340. Three years later, the Ninth Circuit Court of Appeals considered a similar request from a creditor, Dateline, in *Dateline Exports Inc. v. Basic Construction*, *supra*. In the District Court, Dateline petitioned for an injunction and Writ of Attachment (as Straitshot does here) to prevent the Defendant from "selling, transferring, conveying alienating and disposing [of its property]" before adjudication of the underlying causes of action between the parties. The District Court declined to do so and the Court of Appeals upheld the decision of the District Court on the strength of the Supreme Court's unequivocal direction in *Grupo Mexicano*. The Court stated "Under general equitable principles recognized by the United States Supreme Court, a district court lacks authority to issue a preliminary injunction that freezes a debtor's assets in cases involving unsecured creditors." *Dateline, Id*. at 912.

These rulings are an insurmountable obstacle to the relief requested by Straitshot. Apparently recognizing that this is so, Straitshot attempts to draw the Court's attention to decisions issued by the federal courts before the Supreme Court decision in *Grupo Mexicano*,[4] a decision involving a minority shareholder, *Walczak v. EPL Prolong*, 198 F.3d 725 (9th Cir. 1999), (which was distinguished by the 9th Circuit in Dateline because "the injunction was not sought by a creditor who lacked rights in the company's assets." *Dateline, Id*. at 912); and a lone, anomalous decision from a District Court in Texas. Plaintiff's efforts should be rejected out of hand. There is no authority to support Plaintiff's motion for Temporary Restraining Order or a Preliminary Injunction where, as here, Plaintiff hopes to someday be a creditor who has been awarded relief in the form of a money judgment.

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[4] Plaintiff cites to *Republic of the Philippines v. Marcos*, 862 F.2d 1355 (9th Cir 1988) and *Thomas, Head & Greise Employees Trust v. Buster*, 95 F.3d 1449 (9th Cir. 1996), decided 11 years and 3 years before *Grupo Mexicano*, respectively.

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B. Plaintiff does not Meet the Standard to Support Injunctive Relief.

In order to obtain preliminary injunctive relief, a plaintiff must demonstrate (1) a likelihood of success on the merits; (2) a likelihood of irreparable harm in the absence of preliminary relief; (3) a balance of equities tipping in favor of relief; and (4) a weighing of public interest that supports an injunction. *Winter v. Natural Res. Def. Council, Inc.*, 555 U.S. 7, 24-25, 129 S.Ct. 365, 172 L.Ed. 2d 249 (2008). An injunction is an "extraordinary remedy that may only be awarded upon a clear showing that the Plaintiff is entitled to such relief. *Id.* at 28.

1. Plaintiff is unlikely to succeed on the merits of this case.

One of the principal requirements of a party seeking to restrain or enjoin another party is a showing of likely success on the merits of the underlying claim. There is no such showing here. Straitshot contends that in November and December 2008, Defendants Prudell and Radford encouraged Straitshot customers to move their business to Telekenex, or suggested to Telekenex that they solicit the business of Straitshot customers. These contacts, even as alleged in Straitshot's complaint, were negligible. That is, Straitshot's Fifth Amended Complaint names approximately 25 "customers" who were solicited by Prudell and Radford. *See*, FAC ¶¶ 34-164. However, several of these "customers" were actually "prospects" who had no relationship or agreement with Straitshot at all. *See*, e.g. FAC ¶¶ 34, 44, 55. Fifteen of the customers who were allegedly "stolen" by Prudell, Radford or Telekenex were found by a King County Superior Court Judge to be "pre-existing customers" of Prudell and Radford, with whom Prudell and Radford were permitted contact after they decided to leave Straitshot for Telekenex. *See*, Exhibit 1, Decl. of Tift.

Plaintiff has no idea how many customers were actually lost as a result of the actions it attributes to Telekenex, Prudell and Radford. *See*, Gold Tr.[5] at 146:21-147:3 (Q: "How many customers—what is the difference in the universe between [February 16, 2009 when Plaintiff released its customers and encouraged them to find other service providers] and say the end of

[5] Attached as Exhibit 2, Decl. of Tift.

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December 2008?" A [by Straitshot's former CEO, Andrew Gold]: You know, I don't know, to be quite honest, how many had already signed contracts with Telekenex, how many had begun a process of migration, how many had already made the decision to terminate. I can't state that categorically...")

Similarly, Plaintiff does not even pretend to calculate significant lost revenue from the allegedly "stolen" customers. *See*, Gold Tr. at 147:4-148:11. (Q: ...I want to know what the difference in revenue from customers was between December of 2008 and February 16 when that communication [releasing the customers from their contracts with Straitshot] went out." A: "And I'm trying to answer your question.... You know, I couldn't answer that question. We had people that we still considered customers that we had provided—meaning Straitshot—had provided service to in January and February and for which those customers owed Straitshot money. I can't recall how many of them we billed and how many we didn't. Many of them we—in order to get paid at all, we were forced to credit them for the several weeks of service during the times where the disruptions in the network[6] due to the acts of the defendants and their noncooperation with—with our replacement technical team, so, you know, but—So I just can't answer the question other than the long answer I just gave.")

It is not surprising that Straitshot made no effort to account for lost revenues (although it certainly is a problem for proving damages in this case) because Straitshot maintains that a customer cancellation costs them nothing. Straitshot's former CFO, Phil Howe, testified:

> Q Okay. Mr. Gold next writes, "Customers that cancel during the contract pay termination fees and/or order replacement circuits (replacing the cash flow either way)." Do you see that?
>
> A I see that.
>
> Q Do you agree with that statement?
>
> A That was what we assumed, yes, in this particular model.

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[6] The "disruptions in the network" were a result of one of Straitshot's vendors, XO Communications, shutting off service to Straitshot for nonpayment. *See*, Gold Tr. at 66:13-67:14.

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Q Okay. So if you had a customer that canceled during a contract period, you -- your models indicated that the revenue to Straitshot was the same.
...
THE WITNESS: The -- yeah, I mean, the revenue would stay the same. I think -- I think this was for early termination.

Howe Tr. at 108:11-24.

Plaintiff cannot prove damages attributable to the acts of the Defendants and relies, instead, on its theory that a successful solicitation of approximately nine of its customers in a two to three month period of time resulted in the "total destruction" of Straitshot. Plaintiff's theory that it was an ongoing, viable business that was "poised for growth" absent the behaviors attributed to Defendants is belied by its admittedly dire need for additional capital and the overwhelming amount of debt owed to creditors and vendors.[7] Without better evidence of actual harm and/or a showing that Straitshot was not imploding on its own, Plaintiff's claims in this lawsuit have little likelihood of the resounding success that would drive the imposition of the relief demanded in this motion.

2. Plaintiff cannot establish a fraudulent transfer.

Just as Straitshot has not established the likelihood of success on the merits with respect to its substantive claims, Straitshot has no evidence that the transaction between IXCH and TelePacific is anything other than an arms length transaction for fair market value. Recognizing there is no hope of proving that the TelePacific transaction was for "less than reasonably equivalent value," Straitshot summarily informs the Court that "Plaintiff will ultimately be entitled to unwind the First Asset Transfer" which, it is contended, is grounds for the relief

[7] CFO Howe testified he prepared realistic financial projections that showed the company would run out of cash (and therefore be out of business) by 2009 if it could not find another investor. Howe Tr. at 30:3-9. Straitshot did not find another investor in 2008, although Claritage loaned money to Straitshot which the company used, in part, according to Howe, to pay creditors "who were threatening to shut off services." Howe Tr. at 30:23-25. Howe conceded there were monthly "48-hour disconnect notices" from Covad (Straitshot's largest and most important vendor), beginning in November, 2008 which culminated in a January 27, 2009 notice from Covad that if the account was not paid in full by noon the following day, Covad will "terminate service and evaluate its options in fully enforcing its rights under the contract." *See*, Howe Tr. at 78:7-79:13; Exs 455, 461, 470, 475 to Howe Dep.

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requested in this Motion. Plaintiff must do more than state a hoped-for result. Plaintiff proffers nothing in the way of clear and convincing evidence of intent to defraud with respect to the "First Asset Transfer" or any evidence of constructive fraud as to either the Telekenex/IXCH agreement or the IXCH/TelePacific agreement. *See, Clearwater v. Skyline Const. Co., Inc.*, 67 Wn.App. 305, 835 P.2d 257 (1992); *Clayton v. Wilson*, 168 Wn.2d 57, 227 P.3d 278 (2010).

3. Plaintiff has not demonstrated a likelihood of irreparable harm.

The party seeking a preliminary injunction must offer proof of irreparable injury. Showing the mere possibility of irreparable harm is not sufficient to support a request for injunctive relief. *Winter*, 555 U.S. at 28; *Earth Island Institute v. Carlton*, 626 F.3d 462, 474 (9th Cir. 2010). The likely irreparable harm must relate to harm that the plaintiff "has sustained or is immediately in danger of sustaining." *City of Los Angeles v. Lyons*, 461 U.S. 95, 101-102, 103 S.Ct. 1660, 75 L.Ed.2d 675 (1983). "Abstract injury is not enough." *Id.*

Plaintiff theorizes that the TelePacific agreement is a means to dissipate assets and/or make unfair disbursements to favored creditors, but this theory is nothing more than an imagined consequence which is incompatible with the literal terms of the TelePacific agreement. Straitshot has provided absolutely no evidence that the IXCH/TelePacific deal is in any way a fraudulent transfer, or anything other than an arms-length transaction [redacted]. Plaintiff offers nothing more than speculation in support of its claim to irreparable harm, and the possibility that if the TelePacific deal is concluded, there might be insufficient funds to pay off its (presently nonexistent and highly unlikely) judgment.

The contrary is true with respect to IXCH. If IXCH is unable to consummate its agreement with TelePacific, the company will lose the benefit of the sale and be exposed to costs

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associated with the deal and possible termination remedies by TelePacific. Weighing the harm that a preliminary injunction might cause the Telekenex Defendants against Plaintiff's imagined injuries, the balance is clearly against the issuance of a preliminary injunction. *See*, *Los Angeles Memorial Coliseum Com. v. National Football League*, 634 F.2d 1197, 1203 (9th Cir. 1980); *Scotts Co. v. United Industries Corp.*, 315 F.3d 264, 284 (4th Cir. 2002) ("(T)he real issue in this regard is the degree of harm that will be suffered by the plaintiff or the defendant if the injunction is *improperly* granted or denied.")

To add insult to injury, Plaintiff argues that it is entirely unnecessary that they post the bond typically required of a party who is able to secure a prejudgment attachment. Plaintiff contends that the posting of a bond would "thwart" their ability to pursue relief. Whatever the potential that Plaintiff might be "thwarted," the fact is that the Telekenex Defendants will suffer immediate and significant harm if Straitshot is permitted to intervene and interfere in the TelePacific transaction.

4. The balance of equities does not support injunctive relief.

Plaintiff attempts to paint the motives and objectives of the IXCH/TelePacific agreement as sinister and underhanded in order to shift the balance of equities in favor of injunctive relief. For example, Plaintiff complains that it was not aware of IXCH's transaction with TelePacific until May 5, 2011, the day that the deal was announced, and suggests that this is some kind of discovery malfeasance. Indeed, Plaintiff appears to assert that it had a right to know every detail about the TelePacific negotiations from inception based upon discovery requests propounded to Telekenex and/or IXCH. However, no discovery request to Telekenex is pertinent, since Telekenex is not a party to the TelePacific agreement, and the requests to IXCH ask for three categories of documents: (1) documents in IXC's possession related to the Requests tendered to Telekenex on October 25, 2010, (2) documents sufficient to indicate the assets and liabilities of IXC Holdings, Inc., and (3) documents sufficient to indicate the relationship and involvement by

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IXC Holdings, Inc. with either or both of Telekenex and IXC Inc. Despite the absence of a clear discovery request directed to the IXCH/TelePacific transaction, the Telekenex Defendants simply produced the TelePacific documents upon demand to Plaintiff.

Moreover, the idea that *any* discovery requests could require a corporation to provide its most sensitive business information to an adversary, *in real time*, is absurd. Plaintiff is basically asking to be party to (or at least a fly on the wall for) all of IXCH's business decisions and operations, including any and all sensitive negotiations with potential partners, targets or purchasers. As Plaintiff notes in its Brief, the TelePacific Deal has been announced, but *has not closed*. As such, the deal is subject to numerous conditions prior to closing. Consequently, the terms of the TelePacific Deal were (and still are) highly confidential and not publicly disclosed – even at IXCH, information about the structure of the deal is limited to a few key people on a need to know basis. Any argument by Plaintiff's counsel that they should have been apprised of the delicate negotiations between IXC and TelePacific every step of the way is simply unreasonable and does not support—in any way—the request for injunctive relief.

IV. CONCLUSION

Straitshot's TRO request is simply an effort by a plaintiff seeking money damages to try to disrupt the business of a defendant to gain leverage for settlement, which is expressly barred by *Grupo Mexicano* and the cases following it. Telekenex asks that the Court deny Plaintiff's requested relief, and assess costs against Plaintiff for the time spent responding to its Motion.

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Dated: June 6, 2011

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CERTIFICATE OF SERVICE

I hereby certify that on June 6, 2011, I electronically filed the foregoing with the Clerk of the Court using the CM/ECF system which will send notification of such filing to the following:

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Dated: June 6, 2011

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